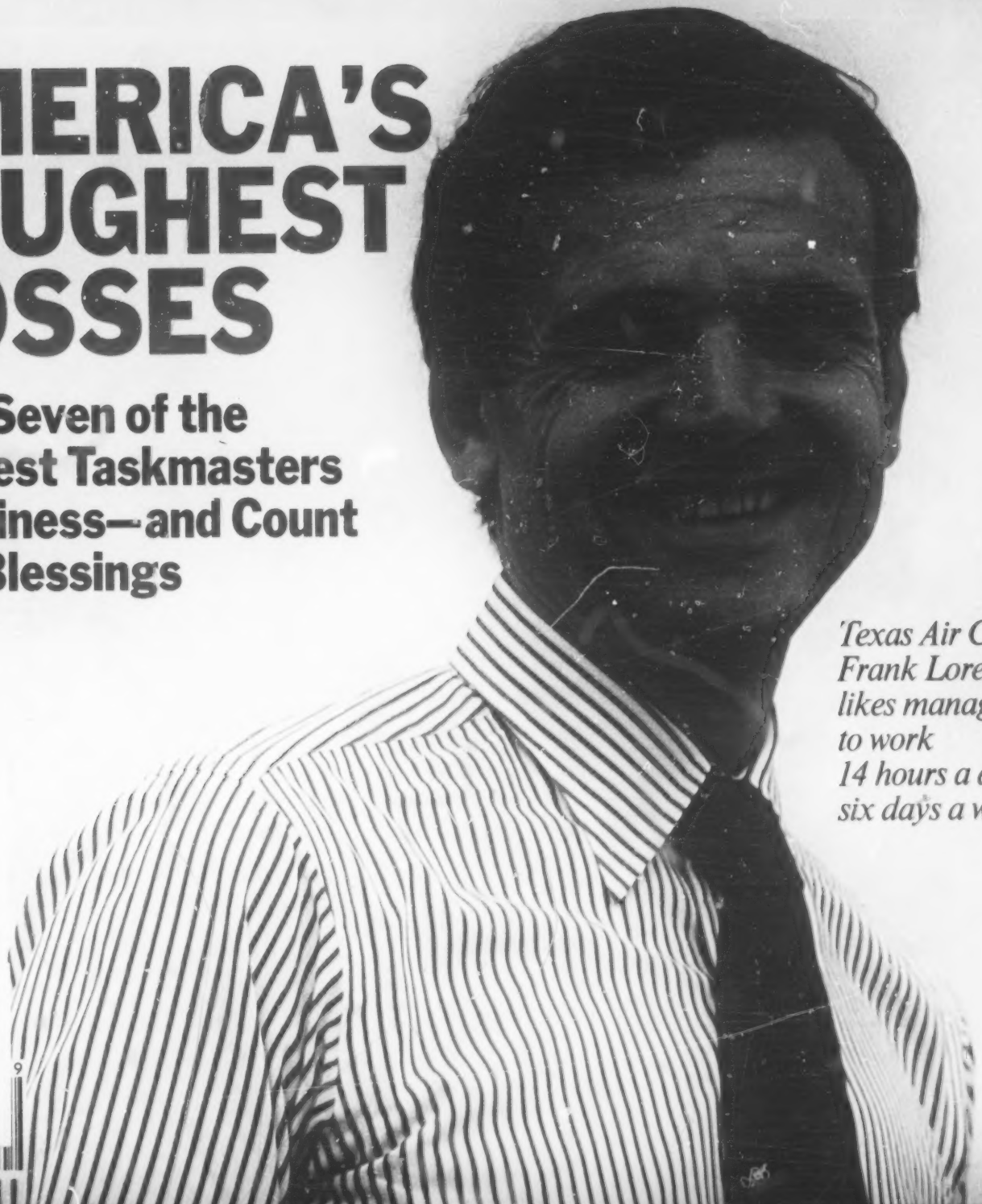
RETIREES' HEALTH COSTS • BONDHOLDERS' REVOLT • TOMORROW'S HOT STOCKS

RUARY 27, 1989 $3.50

FORTUNE

AMERICA'S TOUGHEST BOSSES

Meet Seven of the Steeliest Taskmasters in Business—and Count Your Blessings



Texas Air CEO Frank Lorenzo likes managers to work 14 hours a day, six days a week.

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FEBRUARY 27, 1989

FORTUNE

Lorenzo sometimes creates as much havoc among his crew as he creates among the competition.
COVER STORY/PAGE 40

ABOVE: Photographer Rob Kinmonth caught Texas Air chief Frank Lorenzo staring down some of his pilots.

COVER: Kinmonth photographed Lorenzo at Houston Intercontinental Airport.

MANAGING/Cover Story

AMERICA'S TOUGHEST BOSSES 40

One pulled the pin on a dummy hand grenade in a meeting—to see who would flinch. Another is a master of personal invective. Another tells middle managers not to support their superiors' plans. They're from all sorts of industries—airlines, banking, software—and have different styles. Most are successful, some aren't. They have this in common: They are not a lot of fun to work for. *by Peter Nulty*

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Without paying much attention, companies made rich health-benefit promises to retirees—and their families. Consider Fred, a hypothetical young-at-heart 60-year-old with a 30-year-old wife and new baby. That adds up to 88 years of medical benefits. And Fred won't work one more hour for the company. *by Carol J. Loomis*

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Chief executives think they have no choice but to trim runaway benefits. *by Alan Farnham*

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Screwing owners of bonds is the very stuff that LBOs are made of. Now bondholders are screaming. With Met Life suing RJR Nabisco, the courts will decide. *by Gary Hector*

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"The more stocks rise while the Fed is tightening, the more anxious I get."

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"I won't deny that I know how to chew ass."

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"For me, $25,000 after taxes wouldn't cover one stay in the hospital."

PAGE 58

"If every company were managed like Herman Miller, we would not be concerned about the Japanese right now."

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"To get his goat, they periodically threw out his mail."

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"I had to win the battle, or my life and my family's life would be shattered."

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This is the year America gets serious about twisting arms. Fair enough—except that the U.S. ought not be too pious. *by Rahul Jacob*

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Organized like brain cells, neural networks could become the most powerful form of artificial intelligence. And you can set one up on your own personal computer. *by Brian O'Reilly*

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Inflation and shortages have rattled the Capitalist Roaders in Beijing, but they're not making a U-turn. This is no time for Western companies to pull out. *by Ford S. Worthy*

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In a new book that's bound to stir controversy, the chairman of ITT tells the inside story of a major takeover attempt. He also proposes eight ways to curb predators. *by Rand V. Araskog*

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EDITOR'S DESK

GABE PALACIO

Writer Nulty and reporter Nickel: taming the tough

AMERICANS have long held a fascination for tough guys—George Patton, Humphrey Bogart, you know the type—and our cover stories on America's toughest bosses have been among our best-read features. Right now in business that fascination is stronger than ever; in an era of cutbacks and holddowns, many companies crave hard-edged leaders. Choosing among them all for this issue's cover story (page 40) was tougher than for our previous pursuits in 1980 and 1984. Writer Peter Nulty and reporter Karen Nickel spent three months at it, interviewing the bosses, their past and present associates, security analysts, and management consultants.

ROBIN MOYER

Asian expert Worthy

Some of the toughest CEOs had an unnerving habit of coming on like pussycats in person. Banker Hugh McColl, boss of NCNB, confessed to Nickel, "I'm actually quite afraid of journalists." Carl Reichardt, chairman of Wells Fargo, called out as Nulty left his office, "When you sit down to write, think of my mother—she's 80!"

Others more than confirmed their reputation. Jim Manzi, chairman of Lotus Development, the computer software firm, seemed "incredibly quiet," says Nulty, but he had a reputation for being as judgmental as he was brilliant. "I had heard he liked to use the word 'stupid' a lot. He used that word with me four times."

Nulty himself is a self-confessed softie. With a master's degree in international affairs from Columbia, he came to FORTUNE in 1976 after writing a newsletter from Washington, D.C., on Middle Eastern affairs. "I'm definitely not tough," he says. "I can't ride people, and the closest I've come to running an organization was when I managed a dining club at Wesleyan University." All right, but his editors can tell you that Nulty is properly and impressively tough-minded when making journalistic judgments.

One of the big stories of our time is the triumph of capitalism and the demise of socialism almost everywhere. That is certainly true in most of Asia, and our Southeast Asian editor, Ford Worthy, has just returned from China with a story (page 95) about that vast nation's twisting journey into capitalism. He concludes that although the Chinese Communists are taking some backward steps, they are not retreating from their desire to introduce market forces into their economy—and this is no time for Western companies to be pulling back.

In Worthy's vast territory, many countries are fast industrializing, offering both fresh competition and grand new markets for the West. Says Worthy, who has been on his beat since June: "These are the stories that we will be telling, stories immediately relevant not only to Americans but also to Europeans and Asians—to everyone."

Marshall Loeb

MANAGING EDITOR

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BEST INVESTMENTS

		1979	1989	GAIN
Real estate	Office space in L.A. (7,400 sq. ft.)	**$1 million**	**$3,500,000**	**250%**
Stocks	Hasbro	**$50,000**	**$4,143,500**	**8,187%**
	The Limited	**$50,000**	**$2,404,500**	**4,709%**
	Wal-Mart Stores	**$50,000**	**$2,345,500**	**4,591%**
Mutual funds	Magellan fund	**$50,000**	**$689,930**	**1,280%**
Rare coins	U.S. silver and copper, 1700-1900	**$37,500**	**$133,250**	**260%**
Collectibles	Detective Comics, complete series	**$20,728**	**$118,121**	**470%**
Wine	Château Pétrus, 40 cases	**$10,000**	**$130,000**	**1,200%**

SOURCES: ROULAC/DH&S, WILSHIRE ASSOCIATES, LIPPER ANALYTICAL SECURITIES, STACK'S RARE COIN CO., OVERSTREET PUBLICATIONS, D. SOKOLIN CO.

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JUST THINK . . .

■ Where were you in 1979? That was the year Iran seized 63 U.S. hostages and radiation seeped from the Three Mile Island nuclear plant. For the first time the price of gold eclipsed first $300 an ounce, and then $500. The Fed pushed its discount rate to an unheard-of 12%, and Lee Iacocca visited Washington to get a $1.5 billion loan for Chrysler. The Dow was in the 800s. Investments beckoned, as they always do. If you'd only spotted the ones above. They were among the best. – **William E. Sheeline**

HOW CEOs RELAX

■ Typical CEOs work 59 hours a week, as FORTUNE has reported. But according to a new book, *CEO: Who Gets to the Top in America*, only the gruffest chief executives think leisure is for wimps.

Reading is the No. 1 hobby, say authors Louis E. Boone, David L. Kurtz, and C. Patrick Fleenor, who interviewed more than 100 FORTUNE 500 CEOs to see how they spend their down time. CEOs may quote Iacocca, the authors found, but they are twice as likely to pick up fiction as nonfiction, particularly mystery and detective stories. They devour news and business magazines.

Golf and tennis rank first and second among preferred outdoor sports. Macho transportation industry executives are the most likely to work out. The least likely: CEOs in the medical products industry. Only 25% exercise regularly.

CEOs favor classical and easy-listening music. Seventeen percent like country best. Nine percent prefer opera. Only Wilson H. Taylor, 45, of **Cigna**, goes for rock-and-roll.

Alexander F. Giacco, head of **Himont**, producer of polypropylene, likes to make his own music. When home, he's in his music studio by 5 A.M. arranging compositions. A veteran jazz saxophonist and clarinetist, he's added the guitar, mandolin, banjo, and synthesizer to his repertoire. "Some mornings I play jazz," he says. "Others I'm in the mood for hillbilly tunes."

When Peter L. Scott of **Emhart** is not thinking about artificial intelligence or the consumer electronics his company produces, he's woodworking at his log-cabin retreat, laying parquet floors and carving window frames. Does it get his mind off the job? Says he: "If I think about business while I'm working with rotating saws, I'd lose a finger." **Tyco Laboratories**' John F. Fort climbs mountains. But one day on Mount McKinley, he says, "I thought, 'What a great time for a raider to show up.' The first thing I did when I came down was call the office." – **Julia Lieblich**

ARE YOU READY FOR JUNK FAX?

■ If **Mr. Fax** has your number, you'll be hearing from him soon—if you haven't already. Most nights, the Irvine, California, company launches a blitz of junk fax advertisements to facsimile machines across the country. At least 50 computers dial fax machine numbers and transmit messages of text and graphics to unwitting recipients. Worse, the recipient pays the 3 to 10 cents for the paper the ad uses—the very product Mr. Fax sells in his ads. Other firms advertise flowers and real estate. *All* of them tie up your fax machine.

Junk fax is still relatively new, but many think now is the time to stop it. State representatives in Oregon, Washington, Connecticut, and California are introducing bills that would outlaw the transmission of unsolicited advertising material on facsimile machines.

Mr. Fax President Steve Ridinger argues that a ban on junk fax would violate the First Amendment's guarantee of free speech. Besides, he says, the labor cost of opening and vetting junk mail is more than the

Tyco's John Fort scales New England's Mount Washington; Himont's Alexander Giacco blows a riff.

S. PETER LEWIS

ALAN DOROW

THE KILLER COST STALKING BUSINESS

Without paying attention to what they were doing, companies made some splendid health-benefit promises to retirees. Here come the chickens home to roost. ■ *by Carol J. Loomis*

IMAGINE A RECENT FORTUNE 500 retiree named Fred, a prince of an employee over the years, but right now a corporate horror. Fred, 60, is covered by his company's health plan and has a life expectancy of 78; that's 18 years of health benefits. Young at heart, Fred has a new, 30-year-old wife who can expect to live to 80. She also comes under the company's health plan. So, gulp, does Fred Jr., 1 year old, whose coverage extends through the year he reaches 21. Add it up: 88 years of health benefits to be bestowed on a family that will be performing no work whatever for the company.

The example is obviously extreme. But when the subject is the promises that companies have made about health benefits, words of moderation mislead. All elements of this problem are enormous—the commitments, the expectations of employees, and potentially even their disappointments. Excruciatingly aware of what they have let themselves in for, companies are searching for roads of retreat. Some exist; most are tortuous.

Business is caught up, of course, in a national drama: The $550 billion the U.S. spent on health care last year amounted to nearly 11.5% of GNP, far more than in other industrialized countries. Costs are out of control, having risen since 1980 at a 10.5% annual rate. Many companies would kill to be so lucky. In 1987, General Motors' U.S. health care costs rose by 32%, to nearly $3 billion. Last year, says a consultant, the rise was again "horrendo."

The nation meanwhile equivocates about health costs, clamoring that they be contained yet demanding the easy availability of quality care. But no one wants to write the checks—neither the government, nor business, nor the patients.

The corporate obsession of the moment is retiree benefits, which around 70% of all large companies provide. In one way, these costs are no more than the tip of the iceberg: Typically, a corporation's health expenditures for active employees exceed those for retirees. But the actives *produce* and the retirees do not. Many, like Fred, are under 65 and prodigiously expensive to cover, since they do not yet qualify for Medicare. All those active employees, furthermore, are themselves marching toward retirement in cadence with a rapidly aging population. By the year 2020 or so the demographic profile of the entire nation is expected to match Florida's today: 18% of the population will be over 65.

These facts spell dollars, tons of them, and that reality should long ago have made managers fixated about their retiree costs. But in truth, most slumbered until shocked awake by accounting. Up to now, nearly all corporations have reported their retiree payments as the cash went out the door. But in the offing are new rules that would require companies to estimate all they will pay in the future, charge these obligations to their income statements, and recognize them as a liability on their balance sheets.

The obligations will be huge. One conservative estimate, by the Employee Benefit Research Institute, a nonpartisan, nonprofit organization in Washington, puts the present value of this liability, for all private employers, at $169 billion. Other estimates run as high as $2 trillion, not far below all the liabilities that nonfinancial corporations carry on their books. This vast discrepancy suggests the difficulty of pulling the problem into focus. But even the $169 billion figure implies that retiree health care costs will mangle many companies.

This problem also has a long tail, threatening to wrap itself around just about everybody in the country. Companies that provide retiree benefits feel compelled to attack this cost. But the moral and legal difficulties of cutting benefits for existing retirees have caused many companies to concentrate instead on reducing the benefits of their future retirees, a.k.a. their current employees. Many managements appear to detest this job—and all the other complexities of administering and policing health programs. A growing number yearn for some form of national health insurance to take over the task (see the FORTUNE 500/CNN Moneyline poll that follows).

MANY corporations edged into this bog during World War II, when wages were frozen and labor exacted health plans and other fringe benefits instead. Later, managements blithely extended like coverage to their non-unionized forces, retirees—and themselves. Health benefits have customarily been supremely egalitarian, linked to neither length of service nor salary.

That's one difference from pensions, among many. Most important, managements refused to index pensions to inflation. "Are you crazy?" they asked. "We can't afford that risk." But their health plans embraced indexing without ever using the word. Companies did not state their promises in terms of dollars—"We will give you X amounts to help defray your health costs"—but instead obligated themselves to cover their troops' medical bills, whatever these turned out to be.

They slipped into this awesome error partly because they viewed their health programs as short-term commitments subject to change, not long-term commitments like pensions. That thinking affected the financing of both. Wanting pension commitments to be solid, Washington required corporations to set aside funds to cover them at least partially, made contributions to these accounts tax deductible, and exempted their earnings from income tax. But the government did not prod employers to fund their health promises, nor did it shower them with tax incentives. As a result,

REPORTER ASSOCIATE *Alan Deutschman*

only a few companies have done any funding at all. The rest pay as they go.

The pension vs. health differences—Arnold Schwarzenegger vs. Danny DeVito—extend to financial reporting. Corporations have long treated pensions as a form of deferred compensation. They thus account for these on an accrual basis, actuarially recognizing the cost of an employee's pension over his working life. But they did not bite this bullet with their retiree health plans. Instead, they reported their cash costs and let it go at that.

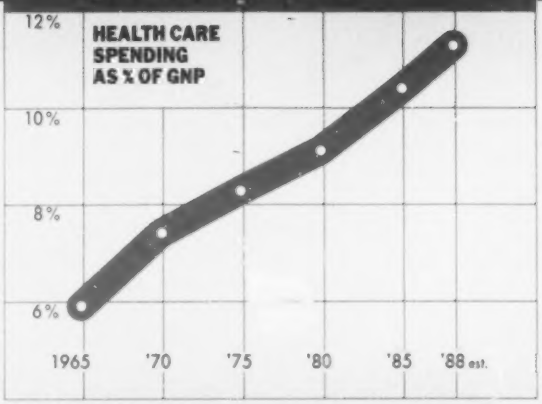
Into this haphazard world has now come the Financial Accounting Standards Board, saying, "These benefits, too, are a form of deferred compensation and thou shalt account for them in precisely that way." For retiree health benefits, then, it's out with pay-as-you-go reporting, in with accruals—which in virtually all cases will be higher.

THE NEW RULES will probably not apply until 1992 and may be modified as FASB exposes them to public and undoubtedly heated debate. But their shape can be anticipated. Corporations will first have to estimate future spending on health benefits for current and future retirees and all covered dependents. They must then discount these obligations to present value and begin charging them gradually to earnings.

These bookkeeping charges, while not affecting the cash companies pay for medical bills, will inflict big damage on that telltale report card, the income statement. The toll will be especially heavy for perhaps 15 years, as companies recognize liabilities built up in the past. After that, the charges will continue to hurt as they are accrued year after year. Meanwhile, each company's balance sheet will display the "debt" owed to retirees, present and future.

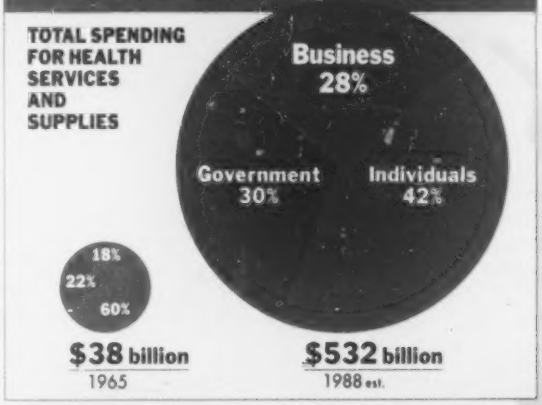
Estimating these obligations will be only slightly easier than making the sun rise in the West and set in the East. Take the example of Mrs. Fred. The company responsible for her must, in effect, estimate what her medical costs will be over 50 years, taking into account price inflation (What will a hip replacement cost in 2030?), the frequency with which she may use medical services (One hip or two?), and the impact of technology (Will they be using gold by then for hips?). And what to make of Medicare, the primary provider for those over 65, with business picking up the extras? Lately Medicare, by extending catastrophic coverage to citizens over 65, has assumed

Health care costs have exploded . . .

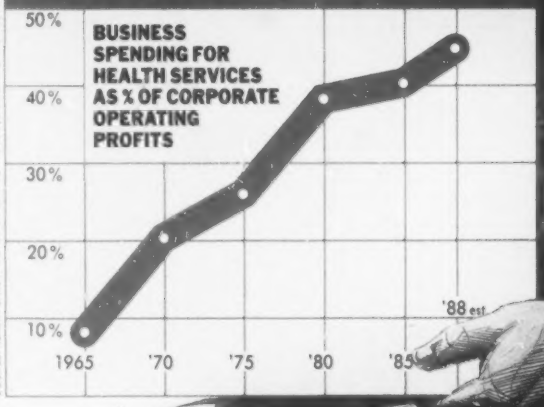


U.S. health costs are the fastest-rising rocket around, and business is paying for much of the fuel. Out of $532 billion spent last year, not including $18 billion for bricks and mortar, its share was $148 billion. Itemized: $106 billion for employees' bills, $27 billion for Medicare hospital insurance, $12 billion for workers' compensation, and $3 billion for in-house medical facilities.

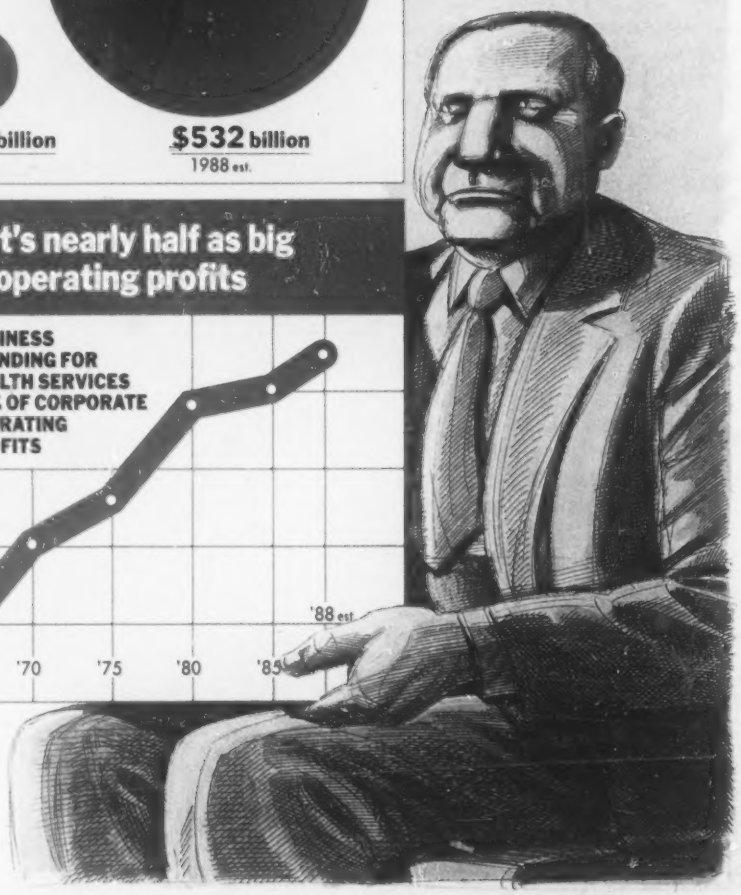
. . . and business is paying a larger share . . .



. . . that's nearly half as big as operating profits



SOURCE: HEALTH CARE FINANCING ADMINISTRATION, DEPARTMENT OF COMMERCE



KEN KERRIS

He won

"Gus" Heck, now in a Florida retirement community, led a lawsuit against Bethlehem Steel over retiree health benefits.

billions in costs formerly borne by business. But will this munificence last—through next year, much less for 49 more?

All these matters will, of course, be dealt with actuarially, though by what warm bodies is not clear. Right now, says Diana Scott, the FASB's project manager on this case, "there just aren't enough actuaries to do all the measurements." Some managements, in any event, will be seeking almost any excuse to forecast slow growth for health costs. Outside consultants say many of their clients are gravitating toward 6.5% to 8.5%, telling themselves that the current out-of-control rates just can't continue. The numbers, in short, are going to be lousy. Says Timothy Lucas, FASB's staff director: "We think they will still be better than what you get now, which is zero."

THERE ARE SOME estimates around and they are ugly. Harold Dankner, a Coopers & Lybrand consultant, has been working with 25 companies that are testing FASB's rules. For many of this crowd, he says, the retiree accrual costs are going to run three to six times the retiree pay-as-you-go costs. The worst dollar blows—no surprise—are due to fall on companies that have demographically mature groups of people to support.

Consider steelmaker LTV, a company mired in bankruptcy since 1986. Retiree health benefits did not exactly put it there. But they were always a rumbling issue, now erupted. Last fall, anticipating FASB's rules, LTV made a massive accrual for retiree health costs, charging $2.3 billion to earnings. That charge says nothing about LTV's ability to pay these costs, which is probably dubious, nor does it clean the company's accrual slate. LTV was simply stating that at its measurement date, year-end 1987, it was estimating $2.3 billion to be the present value of its obligation to its existing retirees and to its active employees for the years they had worked so far.

LTV took this step, says controller William P. Twomey, because the liability is "real" and should be out on the table in the bankruptcy proceedings. But he also acknowledges that LTV had a unique opportunity to get this cost behind it, since it was merely turning its negative net worth into a redder shade of red. Healthier companies, he suspects, could not tolerate the hit, since they would fear the impact on their net worth or on loan covenants.

The average company will indeed string its accruals out. One of the few talking publicly about their financial effects is Du Pont. Currently the company provides health coverage for 100,000 employees, 71,000 retirees or their survivors, and 275,000 dependents, for a total of 446,000 people. Last year, when pretax profits were $3.6 billion, Du Pont's out-of-pocket health costs for this multitude were around $410 million, of which some $180 million went to retirees. But, says A. Herbert Nehrling Jr., director of employee benefits, the company thinks that retiree accruals could be from two to four times the retiree payouts, depending on its assumptions about future health costs. In other words, the retiree expenses hitting Du Pont's 1988 income statement could hypothetically have been $360 million to $720 million, instead of $180 million.

A House committee heard a still spookier estimate last fall from an AT&T actuary, Michael Gulotta, who was representing a coalition of large corporations. He said the average company was facing accruals that would be four to five times its retiree pay-as-you-go expense. Say AT&T is this "average" company. In 1987 its payouts were $319 million, which means its hypothetical accruals would have been $1.3 billion to $1.6 billion. Those are thunderous figures in relation to the company's 1987 pretax profits of $3.2 billion.

Furthermore, comparisons to *pretax*

He lost

Robert Musto, a basketball coach in retirement, sued his former employer, NLT Corp., and its acquirer, American General.

KATHERINE LAMBERT

profits themselves somewhat mislead, since that pair-off implies that these accruals will be costs that can be fully "tax effected"—that is, partially offset on a company's income statement by a reduced provision for taxes. But because of still other accounting rules going into effect for taxes, that will not always be so. Instead, large chunks of the accruals will, in the vernacular, fall straight to the bottom line.

The jolt to be delivered to the securities markets is hard to judge. Some of this heavy news has surely been discounted. Certain security analysts may also play down the new rules as mere bookkeeping that has little immediate relevance to cash flow. On the other hand, these charges could heighten the earnings disparities within industries—between an oldster like Inland Steel, say, and an upstart like Nucor, which does not offer retiree benefits.

The strongest reason for expecting jolts is the paucity of information on the retiree issue. Inexplicably, many companies have not focused at all on what FASB's rules mean for them. "I am staggered by this," says Donald G. McKinnon of the Mercer Meidinger Hansen benefits consulting firm. Some companies even lack a breakdown of today's costs for employees, retirees, and dependents. If companies are themselves so uninformed, it is hard to believe the market has anticipated all the news to come.

MANY MANAGEMENTS are on the prowl for ways to shrink this liability drastically. They carry a legal tool: The fine print in their health-benefit plans customarily notes the right of the employer to change these at will. But the legalities are in the ring with other powerful contenders, including employee relations and humane considerations.

Most important, the fine print will not provide managements with an escape from the essential moral dilemma, which concerns what the retiree is truly owed. Lawsuits brought over this issue have shown that most employees who were promised retiree health benefits never dreamed that they could be forced to bear sharply increased portions of the cost. They thought of their benefits as an entitlement. I worked, they say, therefore I earned.

There you have what Dallas L. Salisbury, president of the Employee Benefit Research Institute, calls the "social consciousness issue." Those not yet retired, Salisbury says, have time to adjust to changes in coverage: "They have time to work longer, time to save." They also have leverage, including the ability to strike or take another job. But, says Salisbury, "someone who is 78 and already has bad health problems does not have the option of finding new savings to pay health insurance premiums he never thought he would have to pay."

ALAN D. LEVENSON

He's suing

Told he had leukemia, Charles Fletcher next heard his former employer, a KKR company, was stopping his medical coverage.

With an adjustment for age, he could almost have been talking about Charles Fletcher, 59, a retired distribution manager of American Forest Products, a California company taken private in 1981 by Kohlberg Kravis Roberts and that firm's most notable financial disaster. In 1983, as AFP cut back operations, Fletcher received $22,500 in severance pay and round-tripped $13,000 of it to AFP in exchange, so he thought, for lifetime health insurance for himself and his wife. Then in early 1988 he learned he had leukemia.

Three months later KKR sold AFP to Georgia-Pacific. AFP's retirees, including Fletcher, received notice from AFP that their health insurance would be terminated, but that they would each be paid $25,000 as compensation. Says Fletcher: "Most are older and come under Medicare, so they accepted. But for me, after taxes, that wouldn't cover one stay in the hospital." So he bitterly refused the $25,000 and is suing AFP and KKR. A lawyer for those companies says a clause in Fletcher's health plan permits the cancellation.

Fletcher joins a swarm of retirees who have sued to try to block their employers from modifying or terminating their health plans. Neither side has scored a legal knockout. "The law is in flux," says Timothy Ryan Jr., of Washington's Pierson Ball & Dowd law firm, which tends to represent the defense. No case has reached the Supreme Court. In district courts, the retirees have often won. Says Ryan: "We can eliminate juries, but we can't eliminate the typical 68-year-old judge. He doesn't like these cases at all." On appeal, where even 68-year-olds may apply the law strictly, judgments for the retirees have often been reversed, on grounds that the fine print is there and that they have no rights of contract.

TWO LAWSUITS, with different verdicts, illuminate the texture of these cases. One action involved NLT Corp., a Nashville insurance company that had been acquired by another insurer, American General, which then sought to conform NLT's medical plan to its own. That meant NLT's retirees, who had been getting cost-free benefits, were hit for a share of the bill and they sued. The lead plaintiff—the kind you get in these cases—was a retired assistant secretary of NLT, Robert Musto, now 61, who had worked for the company 29 years.

continued

The other action involved Bethlehem Steel and its retired managers, whose Blue Cross/Blue Shield policies had until 1985 been paid for by the company. When it then tried to shift some of the cost to the retirees, they sued. Their chief was a Bethlehem veteran of 31 years, Carroll G. "Gus" Heck. Now 63, he had been second-in-command at the company's Buffalo plant.

In the courtrooms where these two disputes were aired, the companies leaned on clauses in their plans permitting changes. In each instance, the retirees said they knew nothing of those clauses and had been orally promised cost-free benefits. The witnesses included managers who had done the promising, sometimes in "exit" interviews in which people set to retire were reminded of their cost-free coverage. NLT, especially, had trumpeted the virtues of its health plan. A retired vice president told about the spiel he delivered at meetings of district managers: "I would hit the fact that they were going to have paid-up medical insurance, hospitalization insurance at no cost to them or their wives after retirement."

In the NLT case, a Nashville district judge, only 54 years old in this instance, came down for the retirees. The promise of benefits, he said indignantly, is not "a mere gratuity, but rather a legal right derived from a unilateral contract." Wrong, said the appeals court, in a decision just handed down. Oral promises, the court said, were outweighed by NLT's written declaration that it could change its plan. Musto and crew are considering an appeal to the Supreme Court.

In the Bethlehem case, a Buffalo district judge, 67, also found for the retirees, 18,000 of them. He dismissed the we-reserve-the-right language in Bethlehem's medical plans as not meaning much, in part because it had been carelessly omitted from two summary documents. To claim the oral representations made at the exit interviews didn't matter, the judge said, would mean that Bethlehem had perpetrated "an enormous fraud" upon the plaintiffs.

Talking appeal, Bethlehem instead settled. In exchange for certain improvements in other benefits, the retirees accepted cost sharing in their Blue Cross/Blue Shield coverage. "It was a win-win situation," says Heck's lawyer, Richard Moot of Buffalo's Moot & Sprague. Seeming to agree, Bethlehem attorney Kathleen Mills says the company wanted to settle because it disliked being "in an adversarial position" with its own people. Says she: "We didn't see that something we forced down their throats through a court decree was going to make for peace, happiness, and wondrous living."

By now, many another company, inspecting this trunk of legal and moral problems, has decided its existing retirees must be treated gently. Or perhaps—you should pardon the expression—grandfathered while the employer moves on to cut the benefits of the next generation of retirees and the next.

A typical 58-year-old retiree runs up medical bills about double those of a 58-year-old still working.

JUST TO BEGIN the exercise, a company must analyze its health plans from stem to stern. What has it promised and to what extent can it back away? The answers may drive it to non-egalitarian "solutions." Consultant McKinnon says many companies are thinking of borrowing a years-of-service concept from pensions. That is, the less time an employee has worked, the less he gets in company-paid benefits when he retires. Pillsbury has already adopted such an approach.

International Paper took a strikingly different tack in a plan it announced to its non-unionized employees in mid-1987. In a stair-step arrangement, the benefits of people who had retired before January 1, 1983, were grandfathered—that is, left untouched. Those who had retired since that date were required to pay increased premiums, while those headed for pasture in the future were told they would then be paying still more. And, last, in a bit of lightning that makes IP a retiree revolutionary, employees hired after October 1, 1987, would not have "subsidized" retirement coverage at all.

"All of us in corporate America know it's time for us to get this escalating cost monster under control."

Yes, says William Fuller, an IP spokesman, that means the company won't pay a cent toward coverage—though it might, for example, help its employees get group rates. Since the company never provided retiree benefits for its hourly paid employees, says Fuller, "over time—a long time—we will eliminate this expense."

IP's plan also requires more premiums from retirees under 65 than from those over, which puts the company on the leading edge of a national trend. Early retirees can be a medical disaster. In the first place, some have retired early because they were sick. Second, sick or well, they are "time rich," able to hang out at the doctor's. Third, as they near 65, they may decide that the optional surgery they were considering should be done on their company's bill, before they have to tangle with Medicare's complexities.

So a corporate retiree of, say, 58 may run up medical bills about double those of the 58-year-old still working. Says Stephen C. Caulfield, a Mercer Meidinger consultant: "I tell my clients that if the only issue is health costs, then they don't want to push people into early retirement." But that is seldom the only issue. Restructurings and leveraged buyouts and even the old stuff, like 30-and-out retirement programs, keep putting these kids on the street.

Happily for IP, it could make its changes without bargaining with its unions. No labor leader has doubts about the value of health benefits and many have leaped to defend them from attack. In 1986, just after LTV went into bankruptcy, it tried to stop paying retiree health costs. The United Steelworkers promptly called a work stoppage—and LTV began paying again. That same year, the Communications Workers of America struck New York Telephone for nine days over issues that included the company's proposal that retirees and current employees start sharing the cost of their health coverage. That issue flamed the longest. "At its end, this strike was about health care, pure and simple," says George Kohl, the CWA's director of research. New York Tel did not get cost sharing.

This year, as contracts for all of the Bell companies come up once more, Kohl says the issues will be "one and two, job security and health care." At Nynex, parent of New York Tel, management is also brooding about health, partly because it dreads FASB's rules. Vice chairman William Burns says progress just has to be made on the union front: "All of us in corporate America know it's time for us to get this escalating cost monster under control."

continued

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LOOKING AHEAD

He touches the heart of the problem. Companies may induce employees to smarten up their purchases of medical services or may even restrict their choice of suppliers. But there will still be a big bill on the plate and somebody—the company or the employee—must pay. Most corporations do not enjoy shifting costs to their employees. But in the interests of shareholders, they are naturally going about the job. The employees are just as naturally resisting. This conflict, sharp even now, is apt to turn brutal as FASB's rules bear down.

SOME CORPORATIONS have meanwhile been seeking help from Washington, campaigning for tax legislation that would permit employers to fund health benefit plans much as they do pension plans. Congress thinks the objective admirable, but not the means of getting there. Because this program would increase corporate tax deductions, it would cut federal revenues. In a read-my-lips era, cuts are not in the cards.

Instead, business may find the tables turned. There is talk of legislation that would cap employers' ability to deduct health costs—perhaps through a per capita limit. Would corporations fight such a measure? Many clearly would. But some might like to make such a cap an excuse for cutting benefits and escaping their "indexed," open-ended promises. Says consultant Caulfield: "I wouldn't be surprised to see industry sit on its hands on this one."

Amazingly, business seems even to be questioning its fundamental beliefs about health. The idea of government-run national health insurance available to all used to be almost universally despised by corporations. But now—behold the irony!—they seem to have experienced a certain conversion. Says Willis Goldbeck, head of the Washington Business Group on Health, a nonprofit organization backed primarily by big companies: "I find more and more businessmen are frustrated with this whole bloody effort. They see managing health as a forever deal. And they say, 'I'm not really in that business. Maybe some sort of national health insurance would make sense.' " Other health experts confirm Goldbeck's findings. There is a shift in the winds and it is not minor.

Nonetheless, the hard gusts of the next few years are apt to swirl mostly around retirees and FASB's rules and precisely who is to pay for a bill we can't pin to the mat. Want a useful suggestion? Tell your kid to become an actuary. ■

NO MORE HEALTH CARE ON THE HOUSE

The bosses who foot the bills for active and retired workers can't bear the increasing burden. Employees had better brace themselves: They're going to have to pay up. ■ *by Alan Farnham*

AMERICA'S TOP CEOs view rocketing health care costs as a drain on profits and a threat to the very competitiveness of U.S. industry. Health care consumes more than 11% of GNP—twice the bite it took 25 years ago and more than any other industrialized nation spends. Business's share of the nation's doctor bill has grown to a staggering 45% of operating profits. While not all executives agree on the cause of this illness, they seem united on treatment: An overwhelming majority have asked present or retired employees to shoulder more of the costs—and nearly as many plan further shifts in the future.

"Saving money isn't enough. You have to save money and make employees happy."

THOMAS FRIST JR.
Hospital Corp. of America

LAWRENCE BARNS

These are among the most striking results of the latest FORTUNE 500/CNN Moneyline CEO Poll. Clark Martire & Bartolomeo, an independent opinion research firm, conducted the survey from January 16 to 24. Respondents were 209 CEOs of FORTUNE 500 and Service 500 companies.

Edmund Pratt Jr., head of Pfizer, the pharmaceutical company, points out that employees who imagine health care to be free are unlikely to consume it wisely. He and fellow CEOs have pricked this bubble by requiring workers to pay part of health care costs. Says G. David Hurd, head of Principal Financial Group, a financial services company: "It's a philosophical thrust, to increase employee cost-consciousness."

Some CEOs feel cost sharing alone is not enough. "It puts the employee back into the decision-making process," agrees Thomas Frist Jr., head of Hospital Corp. of America, "and it has shown results. But we're still not satisfied. In April we'll be instituting a flexible benefits program."

Flex programs typically give employees several choices of how to spend their health care dollars: Traditional "unmanaged" plans let them pick their own doctors, while less expensive "managed" programs require them to use a specified group of doctors—often in a health maintenance organization (HMO)—with which the employer has negotiated favorable rates. Employees who pick the cheaper plans can spend their savings on other benefits, such as child care. Managed plans have spread rapidly and, according to the Health Insurance Association of America, account for 72% of all plans.

Richard Clarke of Pacific Gas & Electric uses a flex plan already. "Every option is priced," he says. "We're entering into contracts with doctors and care givers, including HMOs, where we can negotiate rates. With 27,000 employees, you have a lot of buying power." PG&E has also adopted fitness and diet programs, which Clarke calls "a fruit-and-granola exercise regime." He estimates that the company's health care changes saved $15 million in 1988.

"You could spend less on technology, but you'd spend a lot more burying people."

EDMUND PRATT JR.
Pfizer

Pratt had a powerful incentive to revise Pfizer's health plan: The company's insurer, Metropolitan Life, told him in 1987 that Pfizer's premium would rise 35%. Why? Pratt says Metropolitan explained it to him this way: "You guys are suckers." Pfizer was paying for many kinds of hospital costs from the first dollar. It now requires a $200 deductible—"a modest takeback," says Pratt, "but we got little negative reaction. You have to explain these changes to employees. I did a videotape." Pfizer's subsequent premiums increased far less.

Besides money, morale is at stake when a company starts fiddling with health care. Philip Lippincott, head of Scott Paper,

Q Has your company in the past four years asked active employees or retirees to pay for more of their health costs?

A

Active employees and retirees	36%
Active employees only	46%
Retirees only	Less than 1%
Neither	17%

Q In the next four years do you anticipate asking active employees or retirees to pay for more of their health costs?

A

Active employees and retirees	40%
Active employees only	32%
Retirees only	1%
Neither	13%
Not sure	14%

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"With 27,000 employees, you have a lot of buying power."

RICHARD CLARKE
Pacific Gas & Electric

thinks that how a company announces benefit changes to employees can determine whether those changes gain acceptance. "You must be fully open and candid—no hidden agendas," he says. "We test-marketed our changes, got people's reactions, then held employee meetings around box lunches to talk over specifics." Frist of HCA adds: "Saving money isn't enough. You have to save money *and* make the employees happy."

A minority of CEOs (17%) say they have not asked employees to pay any health care increase. Some companies in tight labor markets feel they must continue offering existing plans to stay competitive. Others intend to make changes but have not decided what to do.

More CEOs have been willing to put the bite on active employees than on the retired. But their reluctance to touch retirees begins to melt as they contemplate the future; 41% say that over the next four years they intend to ask them to pay more. Pfizer's Pratt has already bit both the active and retired. "Our plan gives us the legal right to do it," he notes. Not every company reserves that right, and the courts have questioned whether those that reserve it can exercise it.

How successful have CEOs been at curbing health care costs? Although more than three out of four feel they have had moderate success, only 8% rate their efforts "highly successful." Scott Paper's Lippincott says he hasn't found the savings he had hoped to capture. "It's like squeezing a balloon," he says—as soon as one cost shrinks, another bulges. Herbert Kelleher, chief of Southwest Airlines, says, "Our employees are concerned. They see rising costs as a threat to profitability."

Surprisingly, support for some form of national health coverage appears to be growing among the CEOs, a heavily Republican and conservative group according to past polls. A fifth said that they have grown friendlier to the idea of universal health insurance, and 6% recommended such a plan. Says Avram Goldberg, head of Stop & Shop Cos.: "I think we should explore the potentialities of the Canadian National Health Plan, as was recently advocated in the *New England Journal of Medicine*." A large majority of CEOs still oppose any substantial government program. Richard Zimmerman, head of Hershey Foods, speaks for them when he says, "Get the government involved and they'll just foul it up."

Most CEOs favor a variety of strategies for making the present system work better. The most popular, mentioned by 38%, is establishing procedures to control or reduce costs, such as price guidelines for medical fees. John Tait, head of Penn Mutual Life Insurance, favors pegging fees to an index, perhaps the consumer price index. Pratt, however, cautions against too many restrictions on doctors, who happen to be customers of his: "We must resist the temptation to come down hard on health care providers, because some good doctors left England when they restricted their doctors too much." Scrimping on high technology won't work either, he says: "You could spend less on technology, but you'd spend a lot more burying people."

"Dying is as much a part of life as anything else."

JOHN ROLLWAGEN
Cray Research

Eventually, some feel, Americans may have to change their attitudes about death. John Rollwagen, head of Cray Research, observes that, after all, "dying is as much a part of life as anything else." He questions whether using high-tech procedures on the elderly makes sense in a world of limited resources. A more rational system would stress prevention and natural healing, he says, and "We may have to face the fact that once you'd reached a certain age or level of infirmity, certain treatments might not be available to you." Bruce Seaton of American President Cos., a shipping line, adds, "Too much of total health costs are applied to the last year of life, yet we underspend on care for inner-city children. It's a political problem. The old have tremendous power."

CEOs are no youngsters, and it no doubt pains them to take medical benefits from employees past and present. But as most of them see it, the rising doctors' bill so threatens their corporate health that they have no choice but to operate. F

Q How would you rate your efforts to curb wasteful or excessive use of health services?

A

Highly successful	8%
Moderately successful	77%
Unsuccessful	11%

Q As employers' difficulties with health benefit programs have grown, has your interest in some sort of universal national health insurance plan increased?

A

No	79%
Yes	20%
Not sure	1%

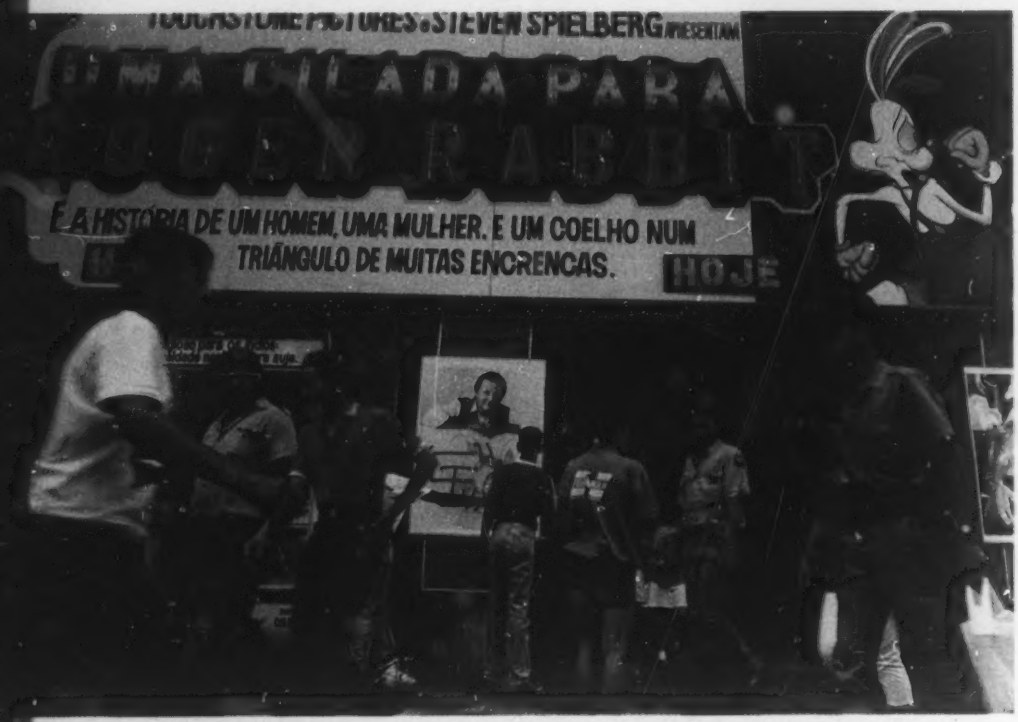
Q If it were in your power to make any change in the U.S. health care system, what would it be?

A

Establish procedures to control or cut costs, such as guidelines for medical fees	38%
Require individuals to assume more of their health costs	15%
Impose limits on malpractice suits	7%
Require greater accountability by medical professionals and hospitals	7%
Adopt a universal national health plan	6%

EXPORT BARRIERS THE U.S. HATES MOST

This is the year that Uncle Sam gets earnest about twisting the arms of countries that perpetrate outrages. Fair enough—but America has plenty to be ashamed of too. ■ *by Rahul Jacob*



Want to show your movie in São Paulo? Sure, says Brazil, if you subsidize local filmmakers.

AN UNWIELDY paperback with a numbing title promises to be one of Washington's best-read books this spring. It isn't yet another serve-and-tattle White House memoir. It will tattle, but on America's trading partners. The 1989 edition of the *National Trade Estimate Report on Foreign Trade Barriers*, put out by the Office of the U.S. Trade Representative (USTR), has a new significance bestowed upon it by the 1988 Trade Act. The act requires the USTR to submit the report to Congress by the end of April, pinpoint the barriers that cost the U.S. the most exports, and start dickering with the offending countries before summer. Recalcitrants will be vulnerable to retaliatory tariffs or bans.

But why wait to get mad? The table opposite highlights barriers that anger U.S. industry the most, either because of their scope or because they are notably perverse. Many countries listed are leading perpetrators of widespread practices. The losses to the U.S., while the best available, are rough estimates.

Some people will doubtless have pet barriers they consider more outrageous. Others will wonder what the fuss is about. "Unfortunately, in today's trading system nothing seems outrageous anymore," says J. Michael Finger, the World Bank's chief of international economic research. While tariff barriers have declined through most of the postwar period, new nontariff forms of protectionism have been multiplying since the early 1970s. Says Columbia University economist Jagdish Bhagwati: "Only the foolish use tariffs these days."

The nontariff barrier's many devilish manifestations include import prohibitions, "voluntary" export restraints, restricted licensing, and the use of antidumping cases to bully trading partners. On volume alone, agriculture dominates the list. Many barriers have been around for decades, since agriculture was exempted from much of GATT's discipline, but new ones keep sprouting. In the current beef over beef, for example, the U.S. has a strong scientific case: The hormones Europeans object to are practically undetectable and were declared safe by U.N. health authorities in 1987.

The greatest distortions are the European Community's export subsidies and variable levies, which are duties equivalent to the difference between already inflated domestic support prices and world market prices. These hit efficient growers everywhere, since the Community's farmers dump their excess production on the world market with the help of generous export subsidies, depressing prices globally. But most other industrial countries also protect their farmers, the U.S. included. Japan's virtual ban on rice imports costs Japanese consumers an estimated $28 billion a year. The U.S. Rice Millers' Association claims that if even 10% of the Japanese market were opened to imports, the resulting lower prices would save the Japanese $6 billion annually and the U.S. would gain a $300 million share of the market.

Manufacturers get less help than farmers, but they get more than enough. Airbus Industrie might well never have flown without support for its member companies from Britain, France, West Germany, and

REPORTER ASSOCIATE *Patricia A. Langan*

PHOTOGRAPH BY CLAUDIO EDINGER—GAMMA/LIAISON

Spain. The hottest seller, the technologically advanced A320, received an estimated $3.4 billion in government development money. Experts agree that the A320 wouldn't be the plane it is without the subsidies; they guess that, competing against a lesser plane, U.S. companies would have exported some $850 million more in 1988. Wolfgang Demisch, managing director of UBS Securities, thinks that the biggest long-term damage to U.S. planemakers will come from the loss of domestic sales.

One handy way to keep a product out is to make it hard to sell. The EC's postal and telecommunications administrations are developing harmonized standards for equipment. Guess who gets to sit out in the hall while specifications are drafted? "Buy national" policies already close the door to much American equipment, and the USTR fears that the new standards may further reduce the U.S.'s already low $500 million share of this $12-billion-a-year market. Policies that favor domestic suppliers exclude most imported equipment from the growing South Korean market.

A still more devious type of barrier coerces importers into subsidizing domestic competitors. Brazil requires foreign videocassette distributors to buy Brazilian film rights, copy the films, and market them. Movie theaters must set aside 140 days a year for domestic films, and foreign distributors have to turn 3.4% of their gross receipts over to Brazilian filmmakers.

Many countries impede imports through a form of piracy when they fail to observe others' patents and copyrights. Pharmaceuticals and software are especially vulnerable to buccaneers in Latin America and Asia. Last October the U.S. struck back at Brazil by imposing 100% tariffs on some $40 million in Brazilian exports—the amount that U.S. pharmaceutical and chemical companies have been losing there annually. Similar negligence in Argentina costs U.S. companies $70 million to $90 million a year. More recently, Thailand has lost an estimated $165 million of its duty-free trading privileges with the U.S. because of its laxity in protecting software and pharmaceutical patents.

The trade act gives the U.S. powerful new weapons for hitting back—too powerful, in fact, if they are used recklessly. "It's the trade equivalent of mutually assured destruction," says Fred Smith, president of the Competitive Enterprise Institute, a public interest group. "You hurt your consumers, and we'll hurt ours." U.S. quotas on textiles, autos, and steel, designed partly to compensate for perceived unfair practices abroad, cost consumers at home billions a year without producing any apparent improvement in the behavior of trading partners.

THE U.S. CANNOT afford to get too pious in any case. It is more sinned against than sinning, but pity the priest who enters a confessional with Uncle Sam's conscience; he will get an earful. U.S. automakers, spared the full force of Japanese competition for years and rolling in money, still can't get enough protection: Now they are agitating for a 25% tariff on imported vans and so-called sport utility vehicles.

A favorite U.S. tool is the use of antidumping and countervailing duties, instruments of fair trade, to harass more efficient foreign suppliers. Companies such as GE and Black & Decker say that domestic makers of commodity bearings, which are used in small motors, are operating at capacity and cannot fill new orders. Nevertheless, prodded by Torrington Co., a major U.S. supplier, the Commerce Department has reached a preliminary conclusion that manufacturers from nine other countries are selling in America for less than at home.

Threatening a dumping action often provides a lever for negotiating such "voluntary" export restraint agreements as steel quotas. Ironically, these restraints often hurt the U.S. more than the exporting country. Robert Crandall, an economist with the Brookings Institution, estimates that the auto restraints the Japanese agreed to in 1981 cost U.S. consumers $160,000 for every American job saved. The quotas also boosted profits on U.S. sales for Japanese automakers, helping them become still more formidable competitors.

The newest U.S. strategy is to ship protectionism abroad via so-called voluntary import expansions. Rather than demand that a trading partner liberalize rules for all comers, the time-honored way of seeking new business, the U.S. asks for specific market shares for its products. But that share has to come from somewhere. When America pressured South Korea to trim its mounting trade surplus in 1987, Korea simply switched some imports of agricultural products from more efficient producers in Argentina and China to the U.S. In the tit-for-tat world of trade barriers, the losers inevitably outnumber the winners. F

TEN TERRIBLE TRICKS OF TRADE

PRODUCT	COUNTRIES	BARRIER	SALES LOST BY U.S. annual, estimated
Grain	European Community	Price supports, variable duties	$2.0 billion
Soybeans	European Community	Price supports	$1.4 billion
Rice	Japan	Ban	$300 million
Beef	European Community	Ban on growth hormones in livestock	$100 million
Commercial aircraft	Britain, France, W. Germany, Spain	Subsidies to Airbus Industrie	Over $850 million
Telecommunications equipment	European Community, S. Korea	Standards stacked against imports	No estimate
Telecommunications satellites	Japan	Ban on import by government agencies	No estimate
Pharmaceuticals	Argentina, Brazil	No patent protection	Over $110 million
Videocassettes, films	Brazil	Requirements to subsidize and market local films	Over $40 million
Computer software	Thailand	Poor patent protection	No estimate